## NEW APPLICATION



#### RECEIVED

1 2

#### BEFORE THE ARIZONA CORPORATION COMMISSION

2005 DEC 16 P 3: 02

3

#### COMMISSIONERS

AZ CORP COMMISSION DOCUMENT CONTROL

4

JEFF HATCH-MILLER, Chairman WILLIAM A. MUNDELL

5

MARC SPITZER MIKE GLEASON

6

KRISTIN K. MAYES

7

8

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR DETERMINATION OF

9

PRUDENCE AND APPROVAL OF RATEMAKING

TREATMENT RELATING TO NATURAL GAS INFRASTRUCTURE

11

10

DOCKET NO. E-01345A-05-0895

APPLICATION

12

13

14 15

16

17

18

19 20

21

22

23 24

25

26

Pursuant to the Arizona Corporation Commission's ("Commission") Policy Statement Regarding New Natural Gas Pipeline and Storage Costs ("Policy Statement"), issued December 18, 2003, Arizona Public Service Company ("APS" or "Company") hereby submits this Application seeking a determination of prudence and approval of the ratemaking treatment for costs incurred or to be incurred under the Phoenix Project Expansion Agreement ("Expansion Agreement") between APS and Transwestern Pipeline Company, LLC ("Transwestern") for natural gas transportation. The diversity in natural gas supply and transportation infrastructure created by the completion of the Phoenix Project will afford APS more flexibility and greater reliability in natural gas deliveries, as well as, offer the potential for the negotiation of future beneficial contract terms, including pricing, by creating competition in transport supplier from producing basins. The Company asks that the Commission find that it is prudent for APS to enter

into the Expansion Agreement and that the costs incurred will be considered as prudently-incurred and subject to full inclusion and recovery in retail electric rates.

#### I. INTRODUCTION AND REGULATORY BACKGROUND

On April 15, 2003, the Commission issued its Notice of Inquiry on the Issue of Arizona Corporation Commission Policy and Action on Natural Gas Infrastructure Matters in Arizona ("NOI"). The NOI recognized the monopoly of El Paso Natural Gas Company's ("EPNG") interstate natural gas pipeline system, as well as both the volatility of natural gas prices and the increased demand being placed on the EPNG system. The Commission sought comments and suggestions on future natural gas infrastructure issues, especially natural gas storage facilities and additional interstate pipelines.

APS responded to the NOI on May 30, 2003. In its response, APS strongly supported the Commission's proactive support of Arizona electric utilities and local gas distribution companies ("LDCs") participating in the development and construction of both natural gas pipeline and storage capacity that will benefit energy consumers in Arizona. The Commission received other responses from electric utilities, LDCs and citizens' groups, all of which supported the Commission's efforts to encourage the development of a reliable energy infrastructure in Arizona.

After reviewing the numerous responses, the Commission scheduled workshops to provide an opportunity for additional discussions among the many interested parties. After significant input and discussion from those parties, including APS, the Commission issued its Final Policy Statement on December 18, 2003. The Policy Statement, while recognizing the need for a reliable and secure natural gas infrastructure, also recognized that cost recovery was a "significant issue" that should be addressed by the Commission. The Policy Statement

encouraged utilities to file applications for consideration by the Commission, including any requests for alternate cost recovery treatment.

To address its future needs for a secure and reliable gas supply and for the means to deliver such supply, APS has continued to review various interstate pipeline and market area storage proposals. On September 15, 2004, the Commission, in Decision No.67239, approved the Company's Application seeking a determination of prudence and approval of ratemaking treatment for costs it would incur in respect to the Silver Canyon Pipeline Project, then proposed by Silver Canyon Pipeline LLC. Ultimately, the Silver Canyon Pipeline Project did not go forward because capacity subscription by non-APS natural gas shippers in Arizona did not materialize. Nevertheless, APS continued to look for other opportunities for the development of necessary natural gas delivery infrastructure in Arizona that would support its utility operations and identified Transwestern's Phoenix Project as such a prospect. Although the Silver Canyon Pipeline Project and the Phoenix Project both supplied the Phoenix Area, what sets the Phoenix Project apart, is the fact that Transwestern proposes to extend the Phoenix Project through Phoenix and on to the Coolidge area, thereby increasing the capacity subscription opportunity to allow the project to go forward.

#### II. DESCRIPTION OF THE PHOENIX PROJECT

The Phoenix Project will offer natural gas transmission services over three interconnected pipeline segments owned and operated by Transwestern, as follows:

(a) Construction of a new 36" pipeline lateral ("Phoenix Lateral") from an interconnection with Transwestern's mainline west of Flagstaff in Yavapai County, Arizona to various points of interconnection in the Phoenix, Arizona area,

as far south as Coolidge, in Pinal County, Arizona, including the APS Redhawk and Sundance Power Plants;

- (b) Construction of pipeline facilities that will result in a 375,000 Dth/day increase in the capacity of Transwestern's existing San Juan Lateral that extends from San Juan County, New Mexico to an interconnection with Transwestern's mainline at Thoreau in McKinley County, New Mexico ("San Juan Expansion II"); and
- (c) Utilization of unsubscribed capacity on the San Juan Lateral and on Transwestern's mainline that (together with the San Juan Expansion II capacity) will result in sufficient total capacity to transport natural gas to the interconnection of Transwestern's mainline and the Phoenix Lateral ("Available Upstream Capacity").

Collectively, the Phoenix Lateral, San Juan Expansion II, and Available Upstream Capacity are referred to in this Application as the "Phoenix Project."

The Phoenix Project is planned to provide the transportation of approximately 500,000 Dth/day of natural gas to the Phoenix area through the installation of an additional 375,000 Dth/day capacity to Transwestern's existing San Juan Expansion and the installation of the Phoenix Lateral, which will connect the Phoenix area with Transwestern's mainline system. This affords the Phoenix area access to gas located in the San Juan producing basin, as well as the Rocky Mountain natural gas producing basin through interconnections with TransColorado and Northwest Pipeline. The Phoenix Lateral is intended to include construction of various points of delivery along its route, including service to APS's Redhawk and Sundance power plants.

#### III. PHOENIX PROJECT AGREEMENT

On December 14, 2005, APS entered into the Expansion Agreement with Transwestern. The Expansion Agreement establishes the conditions and prerequisites for APS to ultimately acquire firm capacity rights on the proposed pipeline pursuant to a Firm Natural Gas Transportation Agreement to be entered into by the parties ("Transportation Agreement"). A redacted copy of the Expansion Agreement is attached as Attachment A.<sup>1</sup>

Under the Expansion Agreement, Transwestern agrees to construct the Phoenix Lateral, undertake the San Juan Expansion II, and place into operation the three interconnected segments that will comprise the Phoenix Project to provide firm natural gas transportation service to meet APS's requirements for a period of fifteen years from the date the Phoenix Project is placed into service. The Transportation Agreement will be executed when the conditions in the Expansion Agreement are met. The redacted Transportation Agreement is attached to the Expansion Agreement. Commencing with the actual in-service date of the Phoenix Project, APS agrees to pay either a negotiated reservation rate ("Reservation Rate") for natural gas transportation service that remains fixed for the term of the Transportation Agreement; or APS may elect to pay an Alternate Rate in lieu of the Reservation Rate that is calculated in accordance with the pricing terms of the Expansion Agreement. In addition, APS will pay Transwestern the applicable usage rate, fuel charge and applicable surcharges as specified in Transwestern's Federal Energy Regulatory Commission ("FERC") Gas Tariff, Schedule FTS-5.

Under the terms of the Expansion and Transportation Agreement, APS retains the ability to change the primary receipt and delivery points, initially set for San Juan deliveries to

<sup>&</sup>lt;sup>1</sup> An unredacted copy of the Expansion Agreement will be provided to Staff pursuant to a protective agreement.

Redhawk and Sundance, subject to the availability of capacity at the time APS seeks to implement the change.

#### IV. GENERAL DISCUSSION

APS, like many electric utilities, has experienced a significant growth in the use of natural gas as a primary fuel for generation of electricity. The Company's electric load growth is expected to continue at a rate significantly above the national average. Consequently, APS's resource plans anticipate a significant growth in the use of gas-fired generation, which can be met either through the running of its own units or through "tolling" arrangements with the gas-fired plants owned by others. Regardless of who owns the gas-fired generation, APS believes an important factor in its ability to manage the electricity costs to its customers is to optimize the integration of the entire natural gas supply chain, including the transportation component.

The interstate natural gas transportation service to all of the APS gas-fired power plants currently is provided by EPNG's southern mainline. The majority of Arizona natural gas consumers and other east of California ("EOC") customers are captive to EPNG because the EPNG system is the only available interstate natural gas transmission option in this region. The service historically was a Full Requirements ("FR") service that allowed EOC customers flexibility in the amount of transportation service available (up to each customer's full requirements) and provided flexibility in the customer choice of supply basin.

As noted in the Commission's Policy Statement, the FERC issued an order requiring the conversion of FR contracts to limited contract demand ("CD") contracts, including APS's Transportation Service Agreement with EPNG. That conversion, effective September 2003, limited the amount of capacity available to APS to a specified amount ("Contract Demand") and

limited APS's flexibility to obtain natural gas from lower-cost supply basins. The conversion to CD contracts heightened both APS's desire and its need for diversification of natural gas transportation options. Given the growth in gas-fired generating facilities interconnecting with the southern EPNG system, the Phoenix Project represents an opportunity for APS to diversify its interstate natural gas transportation portfolio to the benefit of its electric customers and to other natural gas consumers in Southwest Arizona, thereby affording more flexibility and greater reliability in natural gas deliveries from the producing basins, without significant near-term cost increases, even under conservative assumptions.

The changes imposed by FERC in the structure of APS's EPNG Transportation Service Agreement limit the Company's ability to access lower cost supply basins. Transwestern's Phoenix Project provides direct access to the historically lower cost San Juan supply basin. It also provides the ability to easily access the Rocky Mountain supply basin through interconnecting pipelines.<sup>2</sup>

#### V. BENEFITS

The diversity in supply and transportation infrastructure created by completion of the Phoenix Project offers the opportunity for negotiation of beneficial future gas transport contract terms by establishing competition in transport suppliers. A competitive transportation market should allow APS and other natural gas shippers in Arizona to negotiate more favorable

<sup>&</sup>lt;sup>2</sup> Reliability of stable natural gas supplies remains a continuing issue at the present time, considering the impact of the 2005 hurricane season on the Gulf region of the United States. The FERC projects that gas supplies may fall short of the norm in 2006. Although storage injections have put the country in a position to manage cold weather for the rest of winter, gas storage alone may not be able to make up for continuing severe supply reductions in the Gulf. This added strain on available supplies makes the implementation of alternative transportation paths to gas producing basins an even higher priority for Arizona.

transportation agreements which will benefit energy consumers in Arizona. The addition of the Phoenix Project also affords APS the ground level opportunity to leverage this new competition into a favorable, longer term resource for 15 years, thereby stabilizing a portion of the transportation component of natural gas deliveries and affording a hedge against service interruptions through the addition of a new path into the Phoenix area for the supply of natural gas.

Transportation and supply basin diversity will allow APS to mitigate the volatility of gas prices and market risk. This diversity will allow APS to adjust supply sources and fine tune commodity mix to reduce the delivered price volatility to APS of inherently volatile natural gas markets. It is anticipated that the addition of the Phoenix Project pipeline supply will likely create a "market hub" for gas trading in the Phoenix area and increase market liquidity. Such increased local market liquidity may permit more efficient hedging strategies by the Company.

Projects being considered to develop natural gas storage in Arizona also would benefit from increased pipeline options and local market hub development. Storage is more valuable to users when the location has market liquidity and multiple transport options. This optionality can help APS more effectively manage the gas commodity and transportation risks for it's power generation.

#### VI. COSTS

In general, fixed reservation charges for service under a newly constructed pipeline are more expensive than for service from an existing pipeline, and the Phoenix Project is no exception. There are, however, anticipated commodity and variable cost savings with the Phoenix Project that partially offset the increased fixed components. The magnitude of that offset is

dependent upon both the basin differential previously discussed and the level of gas throughput. Any net difference should be viewed as an "insurance" premium to be paid for reliability, flexibility, and competitively-priced options. APS believes this potential, albeit small, premium would be a prudent investment in Arizona's infrastructure to meet the growing demand of its citizens for reliable and affordable natural gas, consistent with the Commission's expectations as expressed in the Policy Statement.

Furthermore, the investment of time and money must be made now to meet Arizona's future gas infrastructure needs. The Phoenix Lateral Segment of the Phoenix Project routing currently contemplated runs to from a point on Transwestern's mainline that is west of Flagstaff, along a southerly corridor into the western side of the Phoenix Metropolitan Area, and then on to Coolidge, where it will serve the needs of APS's Sundance Power Plant. Development in the West Valley is proceeding at a very fast pace and key infrastructure projects such as the Phoenix Project will only become more difficult if undertaken after significant residential and commercial development are in place.

APS has performed an economic analysis comparing the cost for service on the Phoenix Project to the cost for service on the EPNG pipeline. The economic analysis targeted two years, 2009 and 2015, using the native load gas requirements at APS's Sundance and Redhawk Power Plants, which are the initial primary delivery points. Gas supply costs for the analysis include both transportation costs (reservation, usage and fuel) and commodity costs.

The analysis was prepared using conservative estimates of future gas commodity differentials between the San Juan and Permian basins (10 cents/Dth)<sup>3</sup>, and of El Paso rates and services. APS assumed the fixed reservation rate over the 15 year term of the contract. The economic results indicate that the execution of an agreement for Phoenix Project pipeline would result in a relatively small increase (less than 1%) in the gas supply cost for both evaluation years as shown in the tables below:

12<sub>1</sub>

	2009 Yearly Cost		\$ Increase	% Increase	
	EPNG	<u>TW</u>	from EPNG	from EPNG	
Transport	\$31,645,604	\$37, <del>381</del> ,152	\$5,735,548	18.12%	
Commodity	<u>\$271,616,101</u>	<b>\$267,887,832</b>	<u>-\$3,728,269</u>	-1.37%	
Total	\$303,261,705	\$305,268,984	\$2,007,279	0.66%	
	2015 Yearly Cost		\$ Increase	% Increase	
	<b>EPNG</b>	TW	from EPNG	from EPNG	
Transport	\$31,921,736	\$37,600,631	\$5,678,895	17.79%	
Commodity	<u>\$277,114,373</u>	\$272,576,168	<u>-\$4,538,205</u>	-1.64%	
Total	\$309,036,109	\$310,176,799	\$1,140,690	0.37%	

The projected potential increase in the costs for transportation on the Phoenix Project would, in the Company's view, be offset by a number of positive impacts, including: (1) a reduction in the exposure to the higher balancing penalty and variance charges that EPNG has proposed in its 2006 rate case submittal, as well as the possibility of greater than expected increases in EPNG costs going forward; (2) better access to additional natural gas producing basins; (3) the value of competing pipelines; and (4) the reliability benefits of having alternate transportation options.

<sup>&</sup>lt;sup>3</sup> The Transwestern Phoenix Project pipeline provides greater access to the San Juan basin while the EPNG available incremental capacity is limited to the Permian basin, which has historically been at a higher cost and is anticipated to remain there. Thus, the higher the price differential between the basins, the more valuable the Phoenix Project will be. APS's review indicates that the yearly average Permian and San Juan basin differential for 2002 thru 2004 was approximately 43 cents/Dth.

#### VII. KEY MILESTONE DATES

APS anticipates that even under an optimistic time line with no delays, the Phoenix Project will not be available for use until April 30, 2008. To meet that deadline, however, prompt consideration will be necessary by not only the Commission, but also FERC and Transwestern.

Transwestern has established the following timeline for the Phoenix Project:

FERC submittal

August 2006

• Begin construction

July 2007

• Commence operation

April 30, 2008

APS respectfully requests a final decision on this Application by April 1, 2006 to nullify the ACC approval termination provision in the Expansion Agreement and to allow the Phoenix Project to proceed expeditiously to meet the proposed in-service date of April 30, 2008.

#### VIII. PROPOSED PRUDENCE FINDING AND RATE RECOVERY MECHANISM

The Company requests that the Commission find that it is prudent for APS to enter into the Expansion Agreement and that the costs incurred under that agreement and the Transportation Agreement will be considered as prudently-incurred and subject to full inclusion and recovery in retail electric rates. As presently constituted, the costs incurred by APS under the Expansion Agreement and ultimately the Transportation Agreement will be recoverable as gas transportation costs under the Power Supply Adjustment ("PSA") rate mechanism authorized by Decision No. 67744. In the event that the Company's PSA is modified or eliminated such that recovery of the above transportation costs is not possible, APS requests Commission authorization to defer the costs associated with the agreement as a regulatory asset for future recovery in a subsequent base rate case.

#### IX. CONCLUSION

The Expansion Agreement and cost recovery proposed by APS respond to the Commission's concerns regarding natural gas infrastructure in Arizona as set forth in the Commission's Policy Statement and are in the public interest. Accordingly, APS requests that the Commission find the Expansion Agreement to be reasonable and prudent and in support of the Commission's Policy Statement and subject to full inclusion and recovery in retail electric rates.

RESPECTFULLY SUBMITTED this day of December, 2005.

PINNACLE WEST CAPITAL CORPORATION LAW DEPARTMENT

Karilee S. Ramaley Thomas L. Mumaw

1	The original and 13 copies of the
2	foregoing were filed this 16 <sup>th</sup> day of December, 2005 with:
3	Docket Control
4	Arizona Corporation Commission
5	1200 West Washington Phoenix, AZ 85007.
6	Copies of the foregoing mailed, faxed or
7	transmitted electronically this 16 <sup>th</sup> day of December, 2005 to:
8	
9	All parties of record.  Rodina Pasula
10	Rodica Pasula
11	
12	
13	
14	
15	

#### ATTACHMENT A

2	
3	
4	
5	

#### PHOENIX PROJECT EXPANSION AGREEMENT

#### Between Transwestern Pipeline Company, LLC

#### And

#### **Arizona Public Service Company**

(Redacted Copy)

#### PHOENIX PROJECT EXPANSION AGREEMENT

This Expansion Agreement is entered into this \_\_day of \_\_\_\_, 2005, between Transwestern Pipeline Company, LLC, a Delaware limited liability company ("Transwestern") and Arizona Public Service Company, an Arizona corporation ("Shipper").

#### WITNESSETH:

WHEREAS, Transwestern proposes to offer transportation services by (i) constructing a new 36" pipeline lateral ("Phoenix Lateral") from an interconnection with Transwestern's mainline in Yavapai County, Arizona to various points of interconnection in the Phoenix, Arizona area, (ii) constructing pipeline facilities that will result in a 375,000 Dth/day increase in the capacity of Transwestern's existing San Juan Lateral that extends from a point in San Juan County, New Mexico to an interconnection with Transwestern's mainline in McKinley County, New Mexico ("San Juan Expansion II"), and (iii) utilizing unsubscribed capacity on the San Juan Lateral and on Transwestern's mainline that (together with the San Juan Expansion II capacity) will result in sufficient total capacity to transport Shipper's MAXDTQ (as defined below) to the interconnection of Transwestern's mainline and the Phoenix Lateral ("Available Upstream Capacity"). Collectively, the Phoenix Lateral, San Juan Expansion II, and Available Upstream Capacity shall be referred to herein as the "Phoenix Project";

WHEREAS, Shipper desires to obtain firm natural gas transportation service utilizing a portion of the capacity that the Phoenix Project will make available;

WHEREAS, Transwestern has included in the design and scope of the Phoenix Project an interconnection with El Paso Natural Gas Company's southern system that is intended to allow for the delivery of Shipper's MAXDTQ into such system to facilitate the supply of Shipper's electric generation facilities in and around the Phoenix, Arizona metropolitan area; and

WHEREAS, this Expansion Agreement has been executed as evidence of the agreement between Transwestern and Shipper that, subject to the termination rights of the parties set forth below, the parties will enter into a Firm Natural Gas Transportation Agreement providing for firm transportation service to be provided by Transwestern for Shipper that is estimated to begin on or about April 30, 2008.

**NOW, THEREFORE**, in consideration of the premises and mutual covenants set forth herein, Transwestern and Shipper agree as follows:

#### 1. Services

Subject to the terms and conditions set forth herein, Transwestern agrees to provide Shipper with firm transportation service ("Transportation Service") under a new Rate Schedule FTS-5 of Transwestern's FERC Gas Tariff ("Tariff"), pursuant to the Form of

Firm Natural Gas Transportation Agreement attached hereto as Attachment A ("Transportation Agreement").

Shipper shall have, and may exercise, any rights provided under the Tariff and the Natural Gas Act to request changes in the terms and conditions of service that Shipper shall receive under the Transportation Agreement; provided, however, that Shipper shall not seek changes in the Reservation Rate during the term of the Transportation Agreement.

#### 2. Effective Date and Term

This Expansion Agreement shall become effective on the date of its execution by both parties and, unless sooner terminated by the exercise by either Shipper or Transwestern of its termination rights hereunder, shall remain in effect until the execution by Shipper and Transwestern of the Transportation Agreement; provided, however, that upon the execution by Shipper and Transwestern of the Transportation Agreement, the provisions of Sections 7(a) and 7(b) of this Agreement shall continue in full force and effect until the actual in-service date of the Phoenix Project.

#### 3. Rates

Commencing with the actual in-service date of the Phoenix Project, Shipper shall pay for the Transportation Service a negotiated reservation rate ("Reservation Rate") equal to the following: (i) per dekatherm of firm transportation capacity for volumes allocated to a primary receipt point on the San Juan Lateral; or (ii) per dekatherm of firm transportation capacity for volumes allocated to a primary receipt point on that portion of Transwestern's pipeline system that is east of the interconnection at Thoreau, New Mexico of the San Juan Lateral and Transwestern's mainline ("East of Thoreau Area"). The Reservation Rate shall remain fixed for the term of the Transportation Agreement. Shipper may elect, on or before the in-service date of the Phoenix Project, to pay, either of the following rates (each referred to herein as the "Alternate Rate") in lieu of the Reservation Rate during the term of the Transportation Agreement: (a) Transwestern's maximum tariff reservation rate for the applicable path established in the FERC certificate proceeding for the Phoenix Project, as such rate may be changed from time to time during the term of the Transportation Agreement; or (b) a negotiated rate equal to Transwestern's initial maximum tariff reservation rate for the applicable path established in the FERC proceeding for the Phoenix Project, which negotiated rate shall remain fixed during the term of the Transportation Agreement notwithstanding any subsequent changes to the applicable tariff rate. In addition to the Reservation Rate (or the Alternate Rate), Shipper shall pay the applicable commodity rate and applicable surcharges and shall provide a fuel and use quantity as specified in the Tariff; provided, however, that the fuel rate shall not exceed for volumes transported from a primary receipt point on the San Juan Lateral or for volumes transported from a primary receipt point in the East of Thoreau Area.

#### 4. Volume, Term, Receipt and Delivery Points

The contract maximum daily transportation quantity ("MAXDTQ") is stated in Attachment A of this Expansion Agreement. The term of the Transportation Service shall be fifteen (15) years. The term specified and the payment of reservation charges will begin with the actual date the Phoenix Project is placed in service. The Primary Receipt Point(s) and Primary Delivery Point(s) for the Transportation Service are as set forth on Attachment A.

During the term of the Transportation Agreement, Shipper shall have the right to change the primary receipt points and primary delivery points designated on Attachment A, subject to the availability of capacity at the time that Shipper seeks to implement such change. Subject to the last sentence of this paragraph, Shipper shall continue to pay the Reservation Rate or the Alternate Rate established for the original primary path, notwithstanding any such change. If Shipper requests a change in a primary receipt point or a primary delivery point to a point on Transwestern's mainline located west of Thoreau, New Mexico, such request shall be subject to the bid solicitation requirements set forth in Section 24 of the General Terms and Conditions of the Tariff. For purposes of such bid solicitation, Shipper shall bid a rate at least equal to the Reservation Rate (or the Alternate Rate, if applicable). If the rate bid by Shipper is in excess of the Reservation Rate, and Shipper is awarded the capacity as a result of such bid, Shipper shall pay, in addition to the Reservation Rate (or the Alternate Rate, if applicable) such excess amount bid.

Shipper shall have a right of first refusal at the expiration of the term of the Transportation Agreement, in accordance with the Tariff.

#### 5. Shipper's Obligations

(a) Shipper agrees that it will execute the Transportation Agreement within 15 days following the delivery to Shipper by Transwestern of the Transportation Agreement, which delivery will occur no earlier than the acceptance by Transwestern of a certificate from FERC authorizing the construction and operation of the Phoenix Project and no later than the date of commencement of construction of the Phoenix Project; and

- (b) Shipper agrees to support the filings made by Transwestern with the FERC, or with any other governmental agency, to obtain any necessary authorizations to construct and operate the Phoenix Lateral and San Juan Expansion II facilities and the Available Upstream Capacity, including support for the certificate applications.
- (c) During the term of this Expansion Agreement, Shipper shall demonstrate and maintain creditworthiness in accordance with the provisions set forth on Attachment B attached hereto.
- (d) Shipper agrees to make a formal application to the Arizona Corporation Commission, or other applicable governing body, on or before seeking approval for the recovery by Shipper for ratemaking purposes of the costs to be incurred by Shipper under the Transportation Agreement.

#### 6. Timing of Construction

- (a) Transwestern anticipates having the Phoenix Project ready for service by April 30, 2008, conditioned, among other things, upon receipt of all necessary regulatory and other approvals by the project is not ready for service by the date specified in the preceding sentence, provided that if Transwestern is unable to commence the transportation service as contemplated hereunder by such date, Transwestern will proceed with due diligence to commence the transportation service for Shipper at the earliest practicable date thereafter. Transwestern shall provide Shipper at least thirty (30) days notice prior to the date the Phoenix Project is placed in-service.
- (b) Within 30 days following execution of this Expansion Agreement, Transwestern shall provide Shipper with a written schedule that outlines in reasonable detail the plan for development and initiation of operation of the Phoenix Project by April 30, 2008. Thereafter, on a quarterly basis during the term of this Expansion Agreement, Transwestern shall provide Shipper, on or before the last day of each calendar quarter, with a written status report ("Quarterly Report") that shall describe in reasonable detail the progress made by Transwestern through the date of such Quarterly Report in developing the Phoenix Project and achieving project milestones, an analysis of whether the Phoenix Project remains on schedule and on budget, whether Transwestern anticipates any requirement to adjust the projected in-service date (and, if so, what the length of any such adjustment is estimated to be), and a description of future milestones and a schedule for the achievement of such milestones. The significant milestones for the Phoenix Project are expected to include the application for, and receipt of, all necessary FERC and other governmental and regulatory approvals, the ordering and receipt of necessary pipe and other materials, and the acquisition of rights-of-way.

#### 7. Termination Rights

- (a) Shipper shall have the right to terminate this Expansion Agreement (or the Transportation Agreement, if the Transportation Agreement has been executed by both Shipper and Transwestern as of the date of such termination) and elect not to execute the Transportation Agreement or proceed to take transportation service thereunder if:
  - (i) Transwestern shall not have filed an application with FERC pursuant to Section 7(c) of the Natural Gas Act seeking authorization to construct and operate the Phoenix Project upon terms consistent with this Expansion Agreement ("Certificate Application") on or prior to
  - (ii) FERC fails to issue a certificate in response to the Certificate Application ("FERC Certificate") on or prior to
  - (iii) Transwestern has not, on or before necessary to construct the Phoenix Lateral;
  - (iv) construction of the Phoenix Project shall not have commenced on or prior to
  - (v) the Arizona Corporation Commission has not issued an order on or prior to authorizing the recovery by Shipper for ratemaking purposes of the costs to be incurred by Shipper under the Transportation Agreement;
  - (vi) Transwestern has not completed and placed the Phoenix Project in service on or prior to transmission; or

Any such termination by Shipper shall be effected by delivery by Shipper of written notice to Transwestern within 20 business days after the relied upon occurrence. The failure of Shipper to give notice of any event giving rise to a right to terminate this Expansion Agreement, or the waiver by Shipper of any such event, shall not constitute a waiver on the part of Shipper with respect to any subsequent event that would give rise to a right to terminate.

(b) Transwestern shall have the right to terminate this Expansion Agreement (or the Transportation Agreement, if the Transportation Agreement has been executed by both Shipper and Transwestern as of the date of such termination) and elect not to execute the Transportation Agreement (or provide transportation service thereunder) if:



- (iii) Transwestern has not, for any reason, received all governmental and/or regulatory authorizations and all rights-of-way and other rights necessary to construct and operate the Phoenix Project on terms reasonably acceptable to Transwestern on or prior to tune ; unless such failure is the result of any intentional failure by Transwestern, its employees, agents or contractors to apply for or pursue such permits;
- (iv) Shipper fails, at any time during the term of this Expansion Agreement, to demonstrate and maintain creditworthiness in accordance with the provisions set forth on Attachment B hereto;



(vi) The members of CCE Holdings, LLC, the sole owner of Transwestern, have not approved this Expansion Agreement and the transactions contemplated herein on or before December 16, 2005.

Any such termination by Transwestern shall be effected by delivering written notice to Shipper within 20 business days after the relied upon occurrence. The failure of Transwestern to give notice of any event giving rise to a right to terminate this Expansion Agreement, or the waiver by Transwestern of any such event, shall not constitute a waiver on the part of Transwestern with respect to any subsequent event that would give rise to a right to terminate.

(c) Any termination by Shipper or Transwestern of this Expansion Agreement in accordance with the terms to this Paragraph 7 shall be without any liability of the terminating party to the other party; except, however, that to the extent that the termination occurs by reason of Shipper's failure to maintain creditworthiness, Shipper shall, notwithstanding such termination, be liable to Transwestern for (i) a proportionate share (based upon the Shipper's MDQ) of any out-of-pocket costs or other expenses actually incurred by Transwestern or that Transwestern has committed to incur (without the ability to reasonably mitigate) in connection with the Phoenix Project as of the time of the termination notice, provided that Transwestern shall use all reasonable efforts to mitigate such costs and expenses, and (ii) any other remedies that may be available to Transwestern under applicable law.

#### 8. Operational Balancing Agreement

At the time of execution of the Transportation Agreement, Shipper and Transwestern shall both execute the Operational Balancing Agreement in the form set forth in Attachment C hereto, provided, however, that the parties may mutually agree to change the points of interconnection subject to such Operational Balancing Agreement.

#### 9. Confidentiality

Neither Shipper nor Transwestern shall disclose the terms of this Expansion Agreement without prior notice to, and the consent of, the other party; provided, however, that: (i) Transwestern may without prior notice or consent of Shipper, file this Expansion Agreement and the Transportation Agreement as part of any necessary filings with FERC or any other governmental or regulatory authority, and may disclose such information regarding this Expansion Agreement and the Transportation Agreement as is necessary to comply with FERC's transactional posting requirements and the requirements pertaining to negotiated rates; and (ii) Shipper may file this Expansion Agreement with the Arizona Corporation Commission as part of a proceeding to determine whether Shipper shall be entitled to recover from its customers the costs associated with the Phoenix Project. Transwestern may also disclose the terms of this Expansion Agreement and the Transportation Agreement for the purpose of obtaining financing of, or an investment by a third party in, the Phoenix Project. In addition to the foregoing, either Shipper or Transwestern may disclose the terms of this Expansion Agreement and/or the Transportation Agreement to the extent required by applicable law, regulation, court order or subpoena.

#### 10. Authorities

Performance hereunder shall be subject to all valid laws, orders, decisions, rules and regulations of duly constituted governmental authorities having jurisdiction or control of the matter related hereto. Should either of the parties, by force of any such law, order, decision, rule or regulation, at any time during the term of this Expansion Agreement be ordered or required to do any act inconsistent with the provisions hereof, then for the period during which the requirements of such law, order, decision, rule or regulation are

applicable, this Expansion Agreement shall be deemed modified to conform with the requirement of such law, order, decision, rule or regulation; provided, however, nothing herein shall alter, modify or otherwise affect the respective rights of the parties to cancel or terminate this Expansion Agreement under the terms and conditions hereof.

#### 11. Assignment

This Expansion Agreement, in whole or in part, may be assigned by Transwestern, without the consent of Shipper, to an Affiliate (as defined below) of Transwestern established for the purpose of financing the Phoenix Project and/or facilitating the investment by one or more third parties in the Phoenix Project. Shipper may assign this Expansion Agreement without the consent of Transwestern to an Affiliate of Shipper that satisfies the creditworthiness requirements set forth on Attachment B hereto. No other assignment of this Expansion Agreement shall be allowed by either Transwestern or Shipper without the prior written consent of the other party, such consent not to be unreasonably withheld or delayed. As used in this Expansion Agreement, the term "Affiliate" means, with respect to either Transwestern or Shipper, an entity that is under common control with, or is controlled by, Transwestern or Shipper, with "control" meaning the ownership of 50% or more of all voting securities of such entity.

#### 12. Choice and Conflict of Law

THIS EXPANSION AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED, INTERPRETED AND ENFORCED IN ACCORDANCE WITH, THE SUBSTANTIVE LAWS OF THE STATE OF ARIZONA WITHOUT REFERENCE TO ARIZONA'S CONFLICTS OF LAWS RULES.

#### 13. Further Assurances

Transwestern and Shipper shall enter into such additional agreements as may be reasonably necessary in furtherance of this Expansion Agreement.

#### 14. Limitations of Liability

In no event (except in the case of intentional misconduct or gross negligence by Transwestern) shall either Shipper or Transwestern be liable to the other for any special, punitive, exemplary, consequential, incidental or indirect losses or damages (in tort, contract or otherwise) under or in respect of this Expansion Agreement or the Transportation Agreement; provided, however, that in the event of a breach or other non-performance by Shipper of its obligations under this Expansion Agreement, Transwestern shall to the extent permitted under applicable law be entitled to recover Shipper's proportionate share of any otherwise unrecovered out-of-pocket costs or other expenses reasonably incurred by Transwestern or that Transwestern has reasonably committed to incur (without the ability to cancel) in connection with the Phoenix Lateral or San Juan Expansion II facilities.

**IN WITNESS WHEREOF,** the parties hereto have caused this Expansion Agreement to be executed as of the date first written above.

# TRANSWESTERN PIPELINE COMPANY, LLC

## ARIZONA PUBLIC SERVICE COMPANY

Ву:	By:	_
Name:	Name:	
Title:	Title:	

# ATTACHMENT A to EXPANSION AGREEMENT DATED \_\_\_\_\_\_\_, 2005

# Firm Natural Gas Transportation Agreement Rate Schedule FTS-5

Date:\_\_\_\_\_

Shipper's Name and Address for Notices and Invoices:	Address for Invoice (If different)
Attn:	Attn:
Contract No:	
Term: 15 years from the in-service date of the pipeline Commission ("FERC") Docket No. CP ("Phoenix Refusal as set forth in the Tariff.	
Rate: Transwestern shall charge Shipper the rates and	I charges set forth on Appendix A hereto.
This transportation shall be provided pursuant to Subpa	art G of Part 284 of FERC's regulations.
The contract maximum daily transportation quantities a on Appendix B, attached hereto and incorporated herei	
Other: At all times during the term of this Agreement, S on Appendix C attached hereto.	hipper shall satisfy the credit requirements set forth
Any notice, statement, or bill provided for in this Agree having been given if delivered personally, or if mailed to express mail, overnight delivery, telex, telecopy of transmission, to Shipper when sent to the address set sent to the following:	by United States mail, postage prepaid, or if sent by rother mutually agreeable means of electronic

Transwestern Pipeline Company, LLCTranswestern Pipeline Company, LLC

**Payments to Designated Depository:** 

XXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXX

All Notices/Accounting Matters:

XXXXXXXXXXXXXXX

XXXXXXXXXXXXXX

This Agreement shall incorporate and, except for the requirements set forth in Appendix C hereto that are applicable if Shipper fails to maintain creditworthiness, in all respects shall be subject to the "General Terms and Conditions" and the applicable Rate Schedule(s) set forth in Transwestern's FERC Gas Tariff, as may be revised from time to time. Transwestern may file and seek FERC approval under Section 4 of the Natural Gas Act (NGA) at any time and from time to time to change any rates, charges or other provisions set forth in the applicable Rate Schedule(s) and the "GENERAL TERMS AND CONDITIONS" in Transwestern's FERC Gas Tariff, and Transwestern shall have the right to place such changes in effect in accordance with the NGA, and this Transportation Service Agreement shall be deemed to include such changes and any changes which become effective by operation of law and FERC Order, without prejudice to Shipper's right to protest the same; provided, however, that if Shipper elects to pay the fixed Reservation Rate of \$.\_\_ per Dth during the 15 year term of this Agreement in accordance with Appendix A hereto, Transwestern shall not, during such 15 year term, seek any increase in such fixed Reservation Rate.

IN NO EVENT (EXCEPT IN THE CASE OF INTENTIONAL MISCONDUCT OR GROSS NEGLIGENCE BY TRANSWESTERN) SHALL TRANSWESTERN BE LIABLE TO SHIPPER FOR ANY CONSEQUENTIAL, SPECIAL, OR PUNITIVE DAMAGES BASED UPON THE LIABILITY OF TRANSPORTER FOR BREACH OF THIS AGREEMENT OR UPON ANY LIABILITY UNDER ANY OTHER LEGAL THEORY BASED ON ANY BREACH OR ALLEGED BREACH OF ANY OBLIGATION CREATED UNDER THIS AGREEMENT. SUCH EXCLUDED DAMAGES INCLUDE, BUT ARE NOT LIMITED TO, LOST PROFITS.

Transwestern Pipeline Company, LLC	Arizona Public Service Company	
Ву:	Ву:	
Title:	Title:	
Date:	Date:	

#### APPENDIX A

to

# GAS TRANSPORTATION AGREEMENT BETWEEN

TRANSWESTERN PIPELINE COMPANY

and

#### ARIZONA PUBLIC SERVICE COMPANY

Commencing with the in-service date of the Phoenix Project, Shipper shall pay for the Transportation Service provided hereunder a reservation rate ("Reservation Rate") equal to the following: (i) \$0. dekatherm of firm transportation capacity for volumes allocated to a primary receipt point on Transwestern's San Juan Lateral; or (ii) \$0.\_\_\_\_ per dekatherm of firm transportation capacity for volumes allocated to a primary receipt point on that portion of Transwestern's pipeline system that is east of the interconnection at Thoreau, New Mexico of the San Juan Lateral and Transwestern's mainline ("East of Thoreau Area"). The Reservation Rate shall remain fixed for the term of this Agreement. Shipper may elect, on or before the in-service date of the Phoenix Project Facilities, to pay either of the following rates (each referred to herein as the "Alternate Rate") in lieu of the Reservation Rate during the term of this Agreement: (a) Transwestern's maximum tariff reservation rate for the applicable path \_\_, as such rate may be changed from time to time during the term established in FERC Docket No. CP of this Agreement; or (b) a negotiated rate equal to Transwestern's initial maximum tariff reservation rate \_, which negotiated rate shall remain fixed for the applicable path established in FERC Docket No. CP during the term of the Transportation Agreement notwithstanding any subsequent changes to the applicable tariff rate. In addition to the Reservation Rate (or the Alternate Rate, if applicable), Shipper shall pay the applicable commodity rate and applicable surcharges and shall provide a fuel and use quantity as specified in the Tariff; provided, however, that the fuel rate shall not exceed transported from a primary receipt point on the San Juan Lateral or for volumes transported from a primary receipt point in the East of Thoreau Area.

During the term of this Agreement, Shipper shall have the right to change the primary receipt points and primary delivery points designated on Appendix B hereto, subject to the availability of capacity at the time that Shipper seeks to implement such change. Subject to the last sentence of this paragraph, Shipper shall continue to pay the Reservation Rate or the Alternate Rate established for the original primary path, notwithstanding any such change. If Shipper requests a change in a primary receipt point or a primary delivery point to a point on that part of Transwestern's mainline located west of Thoreau, New Mexico, such request shall be subject to the bid solicitation requirements set forth in Section 24 of the General Terms and Conditions of Transwestern's FERC Gas Tariff. For purposes of such bid solicitation, Shipper shall bid a rate at least equal to the Reservation Rate (or the Alternate Rate, if applicable). If the rate bid by Shipper is in excess of the Reservation Rate, and Shipper is awarded the capacity as a result of such bid, Shipper shall pay, in addition to the Reservation Rate (or the Alternate Rate, if applicable) such excess amount bid.

APPENDIX B
to
GAS TRANSPORTATION AGREEMENT
BETWEEN
TRANSWESTERN PIPELINE, LLC
and
ARIZONA PUBLIC SERVICE COMPANY

**Entire Appendix Redacted** 

#### APPENDIX C

to

# GAS TRANSPORTATION AGREEMENT BETWEEN TRANSWESTERN PIPELINE COMPANY and ARIZONA PUBLIC SERVICE COMPANY

Shipper shall establish and, at all times during the term of this Agreement, maintain creditworthiness as determined by Transwestern in accordance with the standard set forth in the General Terms and Conditions of Transwestern's Tariff.

If Shipper is unable, at any time during the term of this Agreement, to establish and/or maintain creditworthiness in accordance with such standard, then, within 10 days of Shipper's receipt of written notice from Transwestern that Shipper has failed to maintain creditworthiness, Shipper shall either: (a) provide one of the following forms of credit support (each hereinafter referred to as "Credit Support"): (i) an irrevocable standby letter of credit issued by a bank acceptable to Transwestern and containing terms acceptable to Transwestern, or (ii) a cash prepayment; or (b) provide to Transwestern a guaranty in a form acceptable to Transwestern of Shipper's obligations under this Agreement, executed by an entity that satisfies such creditworthiness standard.

The amount of any Credit Support to be provided by Shipper shall be determined based on (a) Shipper's proportionate share (based on MAXDTQ) of the cost of the Phoenix Project, with such amount decreased by 6.7% each year during the term of this Agreement, less (b) the present value of the reservation revenue that would be collected if the capacity were resold for the remainder of the term, as determined by an open season held during the 10 day period referenced above and in accordance with Section 24 of Transwestern's tariff ("Mitigation Value").

# ATTACHMENT B to EXPANSION AGREEMENT DATED 2005

Shipper shall establish and, at all times during the term of this Agreement, maintain creditworthiness as determined by Transwestern in accordance with the standard set forth in the General Terms and Conditions of Transwestern's Tariff.

If Shipper is unable, at any time during the term of this Agreement, to establish and/or maintain creditworthiness in accordance with such standard, then, within 10 days of Shipper's receipt of written notice from Transwestern that Shipper has failed to maintain creditworthiness, Shipper shall either: (a) provide one of the following forms of credit support (each hereinafter referred to as "Credit Support"): (i) an irrevocable standby letter of credit issued by a bank acceptable to Transwestern and containing terms acceptable to Transwestern, or (ii) a cash prepayment; or (b) provide to Transwestern a guaranty in a form acceptable to Transwestern of Shipper's obligations under this Agreement, executed by an entity that satisfies such creditworthiness standard.

The amount of any Credit Support to be provided by Shipper shall be determined based on (a) Shipper's proportionate share (based on MAXDTQ) of the cost of the Phoenix Project, with such amount decreased by 6.7% each year during the term of this Agreement, less (b) the present value of the reservation revenue that would be collected if the capacity were resold for the remainder of the term, as determined by an open season held during the 10 day period referenced above and in accordance with Section 24 of Transwestern's tariff ("Mitigation Value").

			·
	<u> </u>		

#### ATTACHMENT C to EXPANSION AGREEMENT DATED 2005

#### OPERATIONAL BALANCING AGREEMENT

between

Transwestern Pipeline Company, LLC

and

#### ARIZONA PUBLIC SERVICE COMPANY

Contract:	
THIS AGREEMENT ("OBA" or "Agreement") made and entered into by and between TRANSWES PIPELINE COMPANY, LLC ("Transporter") and ARIZONA PUBLIC SERVICE COMPANY ("Comp (collectively the "Parties" or individually as "Party"), this day of, 2007.	

#### WITNESSETH

WHEREAS, the facilities operated or to be operated by Transporter and Company interconnect at a point or points specified in the Exhibit 1 attached hereto and incorporated herein by this reference (hereinafter referred to as "Interconnect Point, whether one or more"); and

WHEREAS, Transporter and/or Company (at times hereinafter referred to as the "Parties" or individually as a "Party") have entered into one or more agreements with third party shippers (hereinafter referred to as "Shipper" or "Shippers") for the transportation of gas to or from the Interconnect Point on their respective systems (said agreements hereinafter referred to as "Shipper Agreements"); and

WHEREAS, from time to time, the quantities of gas confirmed by Company and scheduled by Transporter to be delivered to or received from the Interconnect Point (said quantities hereinafter referred to as the "Scheduled Quantities") may be greater or lesser than the quantities of gas which are actually delivered at the Interconnect Point, resulting in inadvertent over- or under-deliveries relative to Scheduled Quantities; and

WHEREAS, the Parties desire to implement a balancing agreement in order to facilitate more efficient operations, accounting, and systems management at the Interconnect Point and on the Parties' respective systems.

NOW, THEREFORE, in consideration of the premises and mutual covenants contained herein, the Parties agree as follows:

1. Prior to the effective date of Shipper nominations at each Interconnect Point, the Parties shall reconcile and confirm nominations received by each Party from Shippers for whom the Parties will be delivering or receiving gas at that point. Such reconciliation and confirmation between the Parties shall be made verbally with subsequent confirmation in writing, unless otherwise mutually agreed to by the Parties. Except as provided in Section 3 below, any changes to such Scheduled Quantities during the month shall be effective only if requested by Shipper or Company and agreed to in writing by both Parties. Such written communication provided by the Parties regarding changes shall be substantially in the form set out on the attached Exhibit 2, or in any other form mutually agreeable to the Parties. All nominations and confirmations must be made in accordance with the requirements of Section 22 of the General Terms and Conditions of Transporter's Tariff. Provided further, the terms and provisions of this OBA shall be subject to Sections 1 - Definitions; 2 - Quality; 4 - Measurement; and 5 -

Measurement Stations, of the General Terms and Conditions of Transporter's FERC Gas Tariff, as may be revised from time to time.

- 2. The Parties intend that the volume of gas actually delivered and received each day at each Interconnect Point will equal the Scheduled Quantities (including Transport Fuel) for that point. Each Party will allocate volumes which are to be delivered and received at an Interconnect Point among the Shipper Agreements on its system pursuant to the Scheduled Quantities received for that point. Any Operational Imbalance created, when the actual physical flow is different than the Scheduled Quantities (on a monthly basis), will be the "Operational Imbalance," which will be the responsibility of the Parties to eliminate pursuant to this Agreement.
- 3. Estimated operating quantities flowing at each Interconnect Point shall be used on a daily basis during any current month to determine the estimated Operational Imbalance at such Interconnect Point, with physical flow adjustments to be made during that current month as mutually agreed to by both Parties to attempt to maintain or achieve an Operational Imbalance of zero at such point; provided, however, nothing herein shall affect Transporter's right to unilaterally re-schedule quantities upon 24-hour notice by Transporter to the Shipper (except in the case of operational distress) under Section 22.3 of the General Terms and Conditions of its FERC Gas Tariff, as may be revised from time to time.
- 4. a) The actual physical flow at each Interconnect Point each month will be determined and communicated in writing by the Interconnect Point Operator to the non- operating Party no later than the 12th of the succeeding month. The Interconnect Point Operator shall be the Party which operates the meter at each Interconnect Point ("Interconnect Point Operator"). Any Operational Imbalance for any calendar month shall be determined on a dekatherm basis, shall be dollar-valued as provided for in Section 5 herein, and shall be provided in the form set forth on Exhibit 3,
  - In the event the parties fail to resolve an Operational Imbalance within ninety (90) days from the end of the month in which the imbalance occurs, or within such other time period which has been mutually agreed to by the Parties, interest shall accrue on the dollar value of the Operational Imbalance from the first day of the first month after the imbalance occurred until the date of payment, in kind or in cash, at the interest rate set forth in 18 CFR 154.67(c)(2)(iii)(A), as may be amended from time to time: provided however, such interest charges shall not be assessed if Transporter is unable to schedule payback gas or Company is unable to receive payback gas from Transporter. Additionally, with respect to Operational Imbalances resulting from underdeliveries by Company which are not resolved within the time specified herein, all subsequent deliveries by Company to Transporter at the Interconnect Point may first be credited by Transporter to the existing Operational Imbalance, and thereafter, to Shippers' scheduled quantities. If the Party owing an Operational Imbalance does not resolve such Operational Imbalance within six months of the last day of the month during which such Operational Imbalance was incurred, then the other Party may, at any time after the expiration of such six month period, submit an invoice to the Party owing such Operational Imbalance for an amount equal to the Dollar Valued Operational Imbalance, as determined and adjusted pursuant to Section 5 below. Such invoice shall be payable in full in accordance with the billing and payment provisions set forth in the General Terms and Conditions.
- 5. Operational Imbalances shall be indexed to a price (hereinafter referred to as the "Monthly Index Price" or "MIP") which shall be calculated as follows, as may be amended from time to time:
  - (a) Transporter shall first determine any Operational Imbalance quantity for each month on a dekatherm basis. Transporter shall then determine a dollar equivalent utilizing the dekatherm quantity and the established MIP ("Dollar Valued Operational Imbalance").
  - (b) For Dollar-Valued Operational Imbalances remaining from previous month(s), the Dollar-Valued Operational Imbalance remaining from the previous month(s) will be added to the Dollar-Valued Operational. Imbalance amount for the Current Month and divided by the current month's MIP to get the volume applicable to the Operation Imbalance for the OBA.
  - (c) The MIP for each month shall equal the average of the daily prices for that month as reported in Gas Daily's table entitled "DAILY PRICE SURVEY" for delivery into Transporter's mainline system "New Mexico- El Paso San Juan Basin". (If a range of prices is shown for any particular day, the midpoint of such range shall represent that day's price at a particular location.) If, for any reason,

- Gas Daily ceases to be available for a particular month, the MIP for that month will equal the average of the applicable daily prices for the above-described location for the applicable month as reported in any other generally accepted available industry publication chosen by Transporter.
- (d) Prices used to calculate the MIP will be prices quoted "into the mainline" in order to eliminate inconsistencies due to varying gathering and treating charges. Transporter will post the MIP for each month on its Internet Website within one (1) business day following the end of the applicable month.
- (e) Subject to the provisions of 4.b. above, Operational Imbalances that may arise from time-to-time may be resolved, on a not unduly discriminatory basis, by payment on an "in-kind" basis or by either Transporter or Company, as appropriate, purchasing volumes necessary to clear the entire Dollar-Valued Operational Imbalance. Transporter will accept nominations for and schedule the volumes necessary to resolve the Operational Imbalance subject to operational considerations.
- 6. Notwithstanding anything herein that may be interpreted to the contrary, in the event that the aggregate Operational Imbalance for all Interconnect Points in any month is outside a 10% tolerance level after completion of all netting and trading activity as outlined in Section 34 of the General Terms and Conditions of Transporter's FERC Gas Tariff (i.e., either exceeds 110% of the quantities scheduled, or is less than 90% of the quantities scheduled), and the Operational Imbalance exceeds 10,000dth, then Company shall be assessed a penalty as described below or Company and Transporter may agree that quantities may be transferred to Transporter's PNR Service to the extent the Company has an effective PNR Agreement. Company shall be subject to all PNR charges. Company will be charged 30 cents per dekatherm (0.30/dth) for volumes outside the tolerance level, although Company will be granted an automatic waiver of such penalty for the first outside-tolerance month in any six-month period. In addition, if Company's deliveries or receipts are outside the tolerance level due to incorrect measurement data communicated to Company by Transporter, any such penalty will be waived. If any Operational Imbalance is due to an operational request of Transporter (which shall be confirmed in writing), or is otherwise caused by Transporter, no penalty shall be assessed. No imbalance penalty should be imposed when a prior period adjustment applied to the current period causes or increases a current month penalty.
- 7. The Dollar-Valued Operational Imbalances that may arise from time-to-time shall be resolved at the option of the Party owing such imbalance on either an "in-kind" basis (upon mutual agreement of the parties as to the timing and location of payback) or by "cash-out" (payment in cash), subject to the receipt of any necessary regulatory approval, by either Transporter or Company as appropriate, purchasing quantities necessary to clear the entire Dollar-Valued Operational Imbalance. Any quantities to be received or delivered by Transporter hereunder in order to resolve an Operational Imbalance must first be scheduled in accordance with Section 22 of the General Terms and Conditions of this Tariff.
- 8. In the event that a capacity constraint occurs on either Party's system which results in curtailment of quantities through an Interconnect Point, the Party on whose system the constraint has occurred shall determine the reallocation of quantities to the Shippers under the affected Shipper Agreements. Such change in Scheduled Quantities shall be confirmed in writing as required by Paragraph 1 above. If the constraint occurs at the Interconnect Point, the downstream Party shall determine the reallocation of quantities to the Shippers under the affected Shipper Agreements.
- 9. All quantities of gas hereunder shall be reported in dekatherms, and shall be determined by multiplying each Mcf of dry gas received and delivered by the dry heating value thereof. Any gas received and delivered to correct an Operational Imbalance shall be adjusted for variations in heating value. Unless otherwise mutually agreed, measurement of gas for all purposes hereunder shall be in accordance with the provisions set forth in Transporter's then-effective FERC Gas Tariff.
- 10. This Agreement is entered into in order to facilitate operations and accounting between the Parties, and shall have no effect upon the Shipper Agreements or upon the effectiveness of any Party's FERC Gas Tariff.
- 11. Company agrees to immediately notify Transporter upon temporary or permanent cessation of gas flow into Transporter at an Interconnect Point or upon acquisition of a new Interconnect Point, and the

Parties agree to timely amend this Agreement to delete or add such Interconnect Points as may be appropriate, by revising Exhibit 1 hereto.

- 12. Any new Interconnect Points between Transporter and Company shall be added to this Agreement prior to the commencement of any gas flow, or shall otherwise be deemed to have been added to this Agreement upon any gas flow.
- 13. This Agreement shall become effective on the first day of the month following execution by both Parties and the in-service date of the facilities to be constructed, if any, and shall continue for a primary term of from the effective date and month to month thereafter; provided, however, either Party may terminate this Agreement at the end of the primary term, or thereafter by providing thirty (30) days prior written notice to the other Party.
- 14. Notwithstanding the termination of this Agreement, the Parties agree to reconcile and eliminate any remaining Operational Imbalance pursuant to the terms and conditions of this Agreement within ninety (90) days of termination of this Agreement or such other period of time which is mutually agreed to by the Parties.
- 15. This Agreement and the terms and conditions herein are subject to all present and future valid laws, orders, rules and regulations of duly constituted authorities having jurisdiction.

		 · · · · · · · · · · · · · · · · · · ·	
40			
16.			
. • .			
	*****	 •	

- 17. This Agreement is for accounting and system management purposes only, and is entered into by the Parties with the understanding that the balancing activities provided for hereunder will not subject any non-jurisdictional entity to regulation by the Federal Energy Regulatory Commission as a "natural gas company" under the provisions of the Natural Gas Act. If, at any time, it should be determined that such balancing activities do result in such regulation, then this Agreement shall immediately terminate, and any remaining Operational Imbalance shall be resolved by the Parties within ninety (90) days after termination of this Agreement.
- 18. Any entity which shall succeed by purchase, merger or consolidation to the properties, substantially as an entity, of either Party, shall be subject to the obligations of its predecessor to this Agreement. No other assignment of this Agreement or of any of the rights or obligations hereunder shall be made.
- 19. AS TO ALL MATTERS OF CONSTRUCTION AND INTERPRETATION, THIS AGREEMENT SHALL BE INTERPRETED IN ACCORDANCE WITH THE LAWS OF THE STATE OF ARIZONA.
- 20. Any notice, request, or statement provided pursuant to this Agreement shall be in writing and shall be considered as having been given, if delivered personally, when delivered, or, if either mailed by United States mail, postage prepaid, sent by express mail, electronically mailed, or overnight delivery, or if telecopied to the other Party, then, when sent, to the following:

Transwestern Pipeline Company, LLC
Market Services
5444 Westheimer Road
P. O. Box 4967
Houston, TX 77056-5306
Fax No.:713/989-1170

ARIZONA PUBLIC SERVICE COMPANY
Attn: Fuel Procurement Gas Transportation Manager
400 N. 5<sup>th</sup> Street, Mail Station 8974
Phoenix, AZ 85004
Fax No.:602/250-3628

Changes to the above addresses shall be effectuated by a Party notifying the other Party in writing of the modification.

- 21. A waiver by either Party of any one or more defaults by the other Party hereunder shall not operate as a waiver of any future default or defaults, whether of like or different character.
- 22. Other Provisions:

IN WITNESS WHEREOF, the Parties hereto have executed duplicate originals of this Agreement on the date set forth hereinabove.

TRANSWESTERN PIPELINE COMPANY, LLC By:	ARIZONA PUBLIC SERVICE COMPANY By:
Senior Vice President	Title:
Transwestern Pipeline Company, LLC Date:	Date:

#### Exhibit 1

# To the Operational Balancing Agreement Between TRANSWESTERN PIPELINE COMPANY LLC AND ARIZONA PUBLIC SERVICE COMPANY Dated: \_\_\_\_\_\_\_, 2008

Interconnect Poi	nt(s) ARIZONA PUBLIC SERVIC	ECOMPANY
Company <u>Meter No.</u>	Transporter POI No.	<u>Description</u>
TBD	TBD	Redhawk Power Generation Plant
TBD	TBD	Sundance Power Generation Plant